

# Other Auditor Reports and Management Response

Independent Auditors' Report on Internal Control over Financial Reporting

Independent Auditors' Report on Compliance with Laws and Regulations

Letter from the Director, Financial Management Office, CDC/ATSDR

Letter from the Acting Associate Director for Budget and Finance and  
Deputy Chief Financial Officer and Director for Finance and Accounting,  
Financial Management Office, CDC/ATSDR



201 M Street NW  
Washington, DC 20036

## Independent Auditors' Report on Internal Control over Financial Reporting

Inspector General of the U.S. Department of Health and Human Services  
and Director of the Centers for Disease Control and Prevention  
and Agency for Toxic Substances and Disease Registry:

We have audited the consolidated totals on the consolidating balance sheet of the Centers for Disease Control and Prevention and the Agency for Toxic Substances and Disease Registry (CDC/ATSDR) as of September 30, 2002, and the related consolidated totals on the accompanying consolidating statements of net cost and changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year then ended (hereinafter referred to as consolidated financial statements), and have issued our report thereon dated December 10, 2002. Our report acknowledges that the CDC/ATSDR changed its accounting for biological products inventory, trust fund receipts, and other matters, and restated certain amounts reflected in the consolidated totals on its fiscal year 2001 consolidating balance sheet. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing our fiscal year 2002 audit, we considered the CDC/ATSDR's internal control over financial reporting by obtaining an understanding of the CDC/ATSDR's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the fiscal year 2002 consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on the CDC/ATSDR's internal control over financial reporting. Consequently, we do not provide an opinion thereon.

Our fiscal year 2002 consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming



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to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the CDC/ATSDR's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the consolidated financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected.

In our fiscal year 2002 audit, we noted certain matters, discussed in Exhibit I, involving the internal control over financial reporting and its operation that we consider to be reportable conditions. However, none of the reportable conditions are believed to be material weaknesses. Exhibit II presents the status of prior year audit findings.

### Additional Required Procedures

As required by OMB Bulletin No. 01-02, we considered the CDC/ATSDR's internal control over the Required Supplementary Stewardship Information by obtaining an understanding of the CDC/ATSDR's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over Required Supplementary Stewardship Information, and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis section of the *Fiscal Year 2002 Chief Financial Officer's Annual Report*, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion thereon.

We also noted other matters involving internal control and its operation that we have reported to the management of the CDC/ATSDR in a separate letter dated December 10, 2002.

This report is intended solely for the information and use of the CDC/ATSDR's management, the U.S. Department of the Health and Human Services Office of the Inspector General, OMB, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

December 10, 2002

## Exhibit I—Summary of Reportable Conditions

### No. 2002-01 Strengthen Controls over Information Systems Environment

The CDC/ATSDR serves as the national focus for developing and applying disease prevention and control, environmental health, and health promotion and education activities designed to improve the health of the people of the United States. To support this mission, the CDC/ATSDR has created an open and distributed computing environment to facilitate collaboration and knowledge sharing. Consequently, the CDC/ATSDR faces the challenging task of maintaining an open computing environment while protecting its critical information assets against malicious use and intrusion. During fiscal year 2002, we found that the CDC/ATSDR was in the process of implementing and refining various aspects of its information security program including documenting security plans for its major applications and general support systems, improving physical access, implementing a managed security service, and developing enhanced disaster recovery capabilities. While these accomplishments are noteworthy, additional actions are necessary to properly secure and to further improve the CDC/ATSDR's information systems control environment. Specifically, we noted that the CDC/ATSDR has not

- fully developed an entitywide risk management framework that includes a process for periodically assessing risks, establishing mitigating controls across the organization, and continuously monitoring the effectiveness of these controls;
- fully updated and formally approved its security plans for all financial applications;
- consistently designed, configured, and reviewed logical security controls to prevent unauthorized access to its networked resources and critical production data;
- fully implemented a Certification and Accreditation process that includes, but is not limited to, performing reviews of security controls, documenting application controls in its security plans and identifying application specific risks, prior to accreditation.

The Computer Security Act requires federal agencies to identify and provide security protection commensurate with the risk resulting from the loss of, misuse of, unauthorized access to, or modification of, information collected or maintained by or on behalf of the agency. The Government Information Security Reform Act reemphasizes that, as part of an agencywide security program, agencies need to ensure that proper security controls are in place to manage information systems

security throughout the life cycle of a system. In addition, Office of Management and Budget Circular A-130 requires agencies to establish a process to certify and accredit information systems and the National Institute of Standards and Technology provides the relevant guidance.

Implementing and maintaining a secure computing environment is a significant challenge and requires senior management sponsorship and dedicated resources. The primary reason for its information system control weaknesses has been that CDC/ATSDR has not yet fully implemented a comprehensive entitywide security management program. An effective program would include assessing risks, establishing appropriate policies and related controls, raising awareness of prevailing risks and mitigating controls, and evaluating the effectiveness of established controls. Although CDC/ATSDR has made progress in strengthening its information security posture, it still needs to take additional steps to fully implement its security management program. These weaknesses place CDC/ATSDR's financial and other sensitive information and assets at risk of unauthorized disclosure or loss and its critical operations at risk of disruption.

## Recommendation

We recommend that the CDC/ATSDR take additional actions to properly secure and further improve the CDC/ATSDR's information system control environment. Specifically, we recommend that the CDC/ATSDR

- fully develop an entitywide risk management framework that includes a process for periodically assessing risks, establishing mitigating controls across the organization, and continuously monitoring the effectiveness of these controls;
- fully update and formally approve its security plans for all financial applications;
- consistently design, configure, and review logical security controls to prevent unauthorized access to its networked resources and critical production data;
- fully implement a Certification and Accreditation process that includes, but is not limited to, performing reviews of security controls, documenting application controls in its security plans and identifying application specific risks, prior to accreditation.

## No. 2002-02 Strengthen Controls over Grants Monitoring Process

The lack of formal policies and procedures and an inadequate number of personnel has resulted in the CDC/ATSDR not closing out expired grants in a timely manner. In fiscal year 2002, the CDC has not closed-out any expired grants and there is a backlog of expired grants from prior years that have not yet been closed. As a result,

amounts due back to the federal government for unallowable costs reimbursements, if any, are not being identified timely to ensure costs can be recovered from grantees. CDC/ATSDR has developed draft closeout procedures and is revising those procedures, with contractor assistance, to provide comprehensive policies and procedures for grants. Contractor assistance has also been obtained to closeout all backlogged grants and to provide closeout assistance for all expired grants on an ongoing basis in fiscal year 2003.

Additionally, the CDC/ATSDR does not currently have a process in place to compare financial information provided by grantees on the Financial Status Reports (FSR) to accounting information maintained by the Payment Management System (PMS), the subsidiary system used to process grant advances and expenditures for the grantee community. As a result, there are no controls at the CDC/ATSDR to ensure that the grant information reported by PMS and reflected on the financial statements matches the information directly provided to the CDC/ATSDR by the grantee.

Although the CDC/ATSDR obtains Single Audit reports as a mechanism for providing grant oversight, these audit reports are not required to be submitted until nine months after a grantee's fiscal year-end. Therefore, obtaining and reviewing Single Audit reports does not provide timely assurance as to the propriety of current year amounts. The CDC/ATSDR also does not have a formal policy regarding grantee site-visits performed by the Grants Specialists for monitoring financial and programmatic aspects of the grant program. The lack of adequate financial and programmatic monitoring procedures may lead to misappropriation of grant funds by grantees.

## Recommendation

We recommend that the CDC/ATSDR

- finalize its closeout procedures related to grants;
- begin to perform closeout procedures utilizing its own resources concurrent with contractor assistance;
- implement procedures to analyze the FSR information provided by the grantees in relation to the payment information in PMS;
- develop formal policies regarding the nature and frequency (i.e., annually) of site visits conducted by the Grants Specialists in order to provide timely assurance as to the propriety of funds expended by grantees.

## No.2002-03    Improve Controls over the Preparation, Analysis, and Monitoring of Financial Information

A combination of three factors: accelerated reporting deadlines; turnover in critical positions; and manually intensive financial reporting processes, resulted in numerous internal control findings relating to the CDC/ATSDR's preparation, analysis, and monitoring of financial information reported in its financial statements. A brief discussion of each of these factors and the specific internal control findings are discussed in the following paragraphs.

Milestone reporting dates are given to the CDC/ATSDR from the Department of Health and Human Services (HHS). The financial reporting due dates were accelerated by approximately 30 days in fiscal year 2002 and they are scheduled to be further accelerated in 2003. Additionally, the CDC/ATSDR is now required to submit financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) to OMB on a quarterly basis.

During fiscal year 2002, the CDC/ATSDR Financial Management Office (FMO) experienced turnover in critical positions and additional experienced management level staff will be lost due to retirement in fiscal year 2003.

Currently, the CDC/ATSDR's financial reporting processes require many adjusting journal entries to be made to prepare the financial statements. These entries are derived from manually intensive processes in order to prepare financial statements in accordance with GAAP.

The high level of findings and the accelerated reporting deadlines support the need for the CDC/ATSDR to streamline and reengineer its current financial reporting processes, and to reassess Financial Management Office (FMO) staffing levels.

Specifically, we identified the following:

- The CDC/ATSDR's central accounting system and existing processes do not facilitate the timely preparation of financial statements in accordance with GAAP. Consequently, at fiscal year end, the FMO had to record over 70 adjusting journal entries to generate GAAP financial statements. Many of these adjusting journal entries could be eliminated by more timely review of journal entries by supervisory staff and performance of account analysis and reconciliations throughout the fiscal year.
- The existing process of recording accounts payable at fiscal year end is also a manually intensive process that is based upon a review of material disbursements subsequent to year-end. With the accelerated deadlines in fiscal year 2002, this presented the CDC/ATSDR with a significant challenge in ensuring



that accounts payable were fairly stated at fiscal year-end. Delays in management completing its analysis and the subsequent audit of such amounts, created additional difficulties for CDC/ATSDR in meeting its reporting deadline with HHS. Our audit of management's accounts payable resulted in additional accruals at fiscal year-end of approximately \$24.5 million.

- Accounts payable and undelivered orders subsidiary records are reconciled to the general ledger on a quarterly basis rather than on a monthly basis as set forth by HHS policies and procedures. Untimely completion of periodic reconciliations may lead to the need for late adjustments and may delay the timely preparation of financial statements.
- The CDC/ATSDR has obligated funds and incurred costs without first obtaining signed reimbursable agreements. Incurring costs against unsigned agreements creates potential budgetary exposure for the CDC/ATSDR in the event the agreements are ultimately not executed.
- Approximately \$11 million of construction in progress was misclassified as buildings in service at September 30, 2002. We also identified construction costs that were expensed rather than capitalized during the year and in prior years. In addition, the CDC/ATSDR had not recorded depreciation on capital lease additions in fiscal year 2002 and had not capitalized software in accordance with HHS's software capitalization policy.
- A capital lease on a building placed in service in October 2000 amounting to approximately \$47 million was incorrectly classified as an operating lease in 2001. While management ultimately identified the error prior to the issuance of the 2002 financial statements, internal controls over the initial classification of building and facility leases needs improvement.
- The CDC/ATSDR does not have a process implemented to review and assess the disposition of unbilled accounts receivable in a timely fashion. We also identified several instances where accounts receivable were being moved from "unbilled accounts receivable" to "billed accounts receivable" in the general ledger but such amounts were never billed. One such item noted was for approximately \$285,000 recorded in fiscal year 1999 that had not been billed through IPAC as of December 2002. Discussions with CDC/ATSDR indicate that these balances were overlooked and should have been collected previously.

## Recommendations

We recommend that the CDC/ATSDR FMO look for opportunities to streamline their year-end closing process and place more reliance on "estimates" where appropriate. One such area is in the recording of accounts payable at fiscal year-end. As



previously mentioned, the CDC/ATSDR, like many organizations, has relied on a review of disbursements subsequent to year-end to determine its accounts payable balances. However, as the reporting deadlines are accelerated this methodology is no longer sufficiently comprehensive to provide management with a reasonable estimate of accounts payable at fiscal year-end. Management needs to pursue other methodologies that are based on statistical trend analysis of payment patterns.

We also recommend that CDC/ATSDR

- Reassess existing staffing levels and competencies in the FMO to ensure that:
  - a sufficient level of resources exists to accomplish the tasks that must be accomplished by the accelerated due dates, and
  - the staff that are assigned are adequately trained to carry out their responsibilities.
- Implement procedures to ensure that amounts are not obligated and expenses are not incurred without a signed reimbursable agreement.
- Ensure that adjusting journal entries are adequately supported and thoroughly reviewed by an appropriate supervisor before they are recorded in the financial statements.
- Establish procedures to ensure that qualifying capital additions and improvements are being capitalized and depreciated in accordance with established policies. In addition, CDC/ATSDR should also perform a review of their expense population on a periodic basis to identify assets that may have been improperly expensed.
- Improve internal controls over the initial classification of building and facility leases.
- Implement accounts receivable procedures to:
  - Research which agencies should be billed through IPAC on each account as they are originated during the year.
  - Ensure that amounts are not reclassified from “unbilled” accounts receivable to “billed” accounts receivable until such time as they are actually billed.
  - Review older account balances to determine whether they are collectible or should be written off.
  - Ensure that personnel and other resources are available to increase the efficiency of the accounting and billing/collection processes.

## Exhibit II—Summary of the Status of Prior Year Findings

Reportable Condition	Status
Analysis and Development of Financial Statements	Condition has not been fully corrected and is repeated in fiscal year 2002 finding No. 2002-03.
Controls over grants – PMS grant accounting	Condition has not been fully corrected and is repeated in fiscal year 2002 finding No. 2002-02.
Reimbursable Agreements	Condition has not been fully corrected and is repeated in fiscal year 2002 finding No. 2002-03.
Controls over grants – Grant Oversight	Condition has not been fully corrected and is repeated in fiscal year 2002 finding No. 2002-02.



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Washington, DC 20036

## Independent Auditors' Report on Compliance with Laws and Regulations

Inspector General of the U.S. Department of Health and Human Services  
and Director of the Centers for Disease Control and Prevention  
and Agency for Toxic Substances and Disease Registry:

We have audited the consolidated totals on the consolidating balance sheet of the Centers for Disease Control and Prevention and Agency for Toxic Substances and Disease Registry (CDC/ATSDR) as of September 30, 2002, and the related consolidated totals on the accompanying consolidating statements of net cost and changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the year then ended (hereinafter referred to as consolidated financial statements), and have issued our report thereon dated December 10, 2002. Our report acknowledges that the CDC/ATSDR changed its accounting for biological products inventory, trust fund receipts, and other matters, and restated certain amounts reflected in the consolidated totals on its fiscal year 2001 consolidating balance sheet. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The management of the CDC/ATSDR is responsible for complying with laws and regulations applicable to the CDC/ATSDR. As part of obtaining reasonable assurance about whether the CDC/ATSDR's fiscal year 2002 consolidated financial statements are free of material misstatement, we performed tests of the CDC/ATSDR's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the CDC/ATSDR. However, providing an opinion on compliance with laws and regulations was not an objective of our audit, and, accordingly, we do not express such an opinion.



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The results of our tests of compliance with certain provisions of laws and regulations described in the preceding paragraph of this report, exclusive of FFMIA, disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02.

Under FFMIA, we are required to report whether the CDC/ATSDR's financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

The results of our tests of FFMIA disclosed instances, described below, where the CDC/ATSDR's financial management systems did not substantially comply with the United States Government Standard General Ledger at the transaction level.

### Compliance with the United States Government Standard General Ledger at the Transaction Level

In accordance with OMB Circular A-127, *Financial Management Systems*, the CDC/ATSDR is required to record financial events consistent with the applicable account descriptions and attributes reflected in the United States Government Standard General Ledger (SGL) at the transaction level. However, the CDC/ATSDR accounting system transaction code posting models were not configured to record the following transactions consistent with the SGL:

- upward and downward adjustments;
- travel advances, however, the posting model was corrected in August 2002 to include the necessary budgetary entries;
- appropriated capital related to reimbursable expenses;
- revenues associated with the CDC/ATSDR's four appropriated Trust Fund accounts.

The CDC/ATSDR recorded manual adjusting entries to correct the misstatements associated with each of the above issues.

### Recommendation

We recommend that the CDC/ATSDR configure its accounting system transaction code posting models to record the above transactions consistent with the SGL.

The results of our tests of FFMIA disclosed no instances in which the CDC/ATSDR's financial management systems did not substantially comply with federal financial management systems requirements or federal accounting standards.



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This report is intended solely for the information and use of the CDC/ATSDR's management, the U.S. Department of Health and Human Services Office of the Inspector General, OMB, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

December 10, 2002



DEPARTMENT OF HEALTH &amp; HUMAN SERVICES

Public Health Service

Centers for Disease Control  
and Prevention (CDC)  
Atlanta, GA 30030

January 8, 2003

Mr. Paul M. Geraty  
KPMG LLP  
2001 M Street, N.W.  
Washington, D.C. 20036

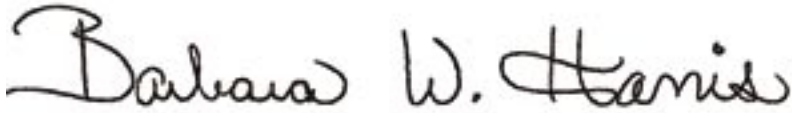
Dear Mr. Geraty:

We have reviewed the recommendations contained in the Independent Auditors' Report on Internal Control over Financial Reporting, including Exhibit I, Summary of Reportable Conditions for the fiscal year ended September 30, 2002. CDC and ATSDR concur with the recommendations, and we appreciate the advice provided by our auditors. Although the report is generally positive, it also highlights needed improvements in our information systems, grants monitoring, and financial reporting. We are committed to attaining these objectives, and we would like to highlight a few CDC initiatives that support our commitment to long-term financial improvement.

Since FY 2001, CDC has been an active participant in the HHS initiative to develop a uniform financial management system (UFMS), and CDC has been selected to be the first HHS operating division to implement the new UFMS system. During FY 2002, we automated our reimbursable billings; enhanced the automation of our year-end closing transactions; and significantly streamlined our year-end closing processes to accommodate accelerated reporting dates. We also implemented a new indirect cost allocation methodology that was developed with assistance from a private consulting firm. CDC is also actively participating in various E-Government projects such as e-Grants, e-Travel, and Enterprise Human Resources and Payroll. Recruitment and training of a highly skilled workforce is another high priority. CDC's Financial Management Certificate Program was developed in FY 2002 to provide technical training for staff members who want to enhance their career opportunities. Presently, more than 200 CDC employees are enrolled in the certificate program.

In summary, CDC must balance several major priorities during the near future. Workforce development, E-Government, implementation of a new financial system, and maintenance of our current system will pose significant challenges. However, we will strive to implement the audit recommendations while also meeting the many other commitments that are critical to our programs.

Sincerely,

A handwritten signature in dark ink, reading "Barbara W. Harris". The signature is written in a cursive, flowing style.

Barbara W. Harris

Acting Associate Director for Budget and Finance and  
Deputy Chief Financial Officer and Director for Finance and Accounting